DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 05-0356
Sales and Use Tax
For Tax Years 2004

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ISSUE

I. Sales and Use—Aircraft Purchase

Authority: Gregory v. Helvering, 293 U.S. 465 (1935); Horn v. Commissioner of Internal Revenue, 968 F.2d 1229 (D.C. Cir. 1992); Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570 (2nd Cir. 1949); IC 6-8.1-5-1; 45 IAC 2.2-5-15; 45 IAC 2.2-4-27; Black's Law Dictionary (7th ed. 1999)

Taxpayer protests the imposition of use tax on the purchase of an aircraft.

STATEMENT OF FACTS

Taxpayer purchased an aircraft and claimed an exemption from sales tax on the purchase. The Department of Revenue ("Department") reviewed the claim for exemption and determined that taxpayer did not qualify for the exemption. As a result of this determination, the Department issued an assessment for use tax on the purchase price of the aircraft. Taxpayer protests the assessment and the determination that it does not qualify for the exemption. Taxpayer failed to attend the scheduled administrative hearing. An individual claiming to represent the taxpayer called shortly before the scheduled administrative hearing to request that the hearing be rescheduled. There was no indication in the file that the taxpayer had representation and the hearing officer explained that the Department required a signed Power of Attorney (POA) form before any discussion of the taxpayer's protest could take place. The individual claiming to represent the taxpayer agreed to send in a POA, and the hearing officer agreed to reschedule the hearing to the next week at the same day and time. No one showed up for the rescheduled hearing either, and no explanation was provided. The Letter of Findings (LOF) is based on the information already in the file. Further facts will be supplied as required.

I. Sales and Use—Aircraft Purchase

DISCUSSION

Taxpayer protests the imposition of use tax on its purchase of an aircraft. Taxpayer purchased the aircraft in September 2004 for a purchase price of five hundred fifteen thousand, seven hundred eighty eight dollars ($515,788.00) but did not pay sales tax on the purchase. Taxpayer claimed the exemption for resale, rental or leasing. The exemption is found in 45 IAC 2.2-5-15, which states:

(a) The state gross retail tax shall not apply to sales of any tangible personal property to a purchaser who purchases the same for the purpose of reselling, renting or leasing, in the regular course of the purchaser's business, such tangible personal property in the form in which it is sold to such purchaser.
(b) General rule. Sales of tangible personal property for resale, renting or leasing are exempt from tax if all of the following conditions are satisfied:
    (1) The tangible personal property is sold to a purchaser who purchases this property to resell, rent or lease it;
    (2) The purchaser is occupationally engaged in reselling, renting or leasing such property in the regular course of his business; and
    (3) The property is resold, rented or leased in the same form in which it was purchased
(c) Application of general rule.
    (1) The tangible personal property must be sold to a purchaser who makes the purchase with the intention of reselling, renting or leasing the property. This exemption does not apply to purchasers who intend to consume or use the property or add value to the property through the rendition of services or performance of work with respect to such property.
    (2) The purchaser must be occupationally engaged in reselling, renting or leasing such property in the regular course of his business. Occasional sales and sales by servicemen in the course of rendering services shall be conclusive evidence that the purchaser is not occupationally engaged in reselling the purchased property in the regular course of his business.
    (3) The property must be resold, rented or leased in the same form in which it was purchased.

Taxpayer believes that it is entitled to this exemption.

The Department denied the claim for exemption due to the fact that the lease was not an arms-length transaction. The Department based its decision on several factors. First, the lessor and the lessee in the leasing arrangement are owned by the same individual. Second, the rental rate was less all expenses of the lessee, resulting in a rental rate far below the normal market rate. 45 IAC 2.2-4-27(d) states in relevant part:

> The rental or leasing of tangible personal property, by whatever means effected and irrespective of the terms employed by the parties to describe such transaction, is taxable.
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> (1) Amount of actual receipts. The amount of actual receipts means the gross receipts from the rental or leasing of tangible personal property without any deduction whatever for expenses or costs incidental to the conduct of the business. The gross receipts include any consideration received from the exercise of an option contained in the rental or lease agreement; royalties paid, or agreed to be paid, either on a lump sum or other production basis, for use of tangible personal property; and any receipts held by the lessor which may at the time of their receipt or some future time be applied by the lessor as rentals.
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> …

This regulation means that taxpayer was required to collect sales tax on all consideration it received from its customer for lease of the aircraft. Taxpayer was not collecting sales tax on the consideration it received from its customer when the customer paid for insurance, hangar, fuel, maintenance and crew. This is evidence that taxpayer's relationship with its customer was not a valid lessor/lessee relationship. Third, the rate was to be charged on a monthly basis pro-rated for any partial month, without regard to the actual number of hours flown. The lessee could fly the aircraft for any number of hours per month, which could result in an extremely low rate per hour.

Fourth, the insurance policy held by the lessor lists the "purpose of use" of the aircraft as, "Pleasure and Business: means personal and pleasure use in connection with the Insured's business, transportation of executives, employees, guests and customers, but *excluding* any operation for which a charge of any kind is made." (emphasis in original) The insurance policy also defines the only special uses as "Dual Flight Instruction to named Pilots Only", and then names as the only pilot the same individual who owns lessor and lessee. The individual is listed as a student pilot, not a commercially licensed pilot. Fifth, taxpayer is registered with the Department for quarterly Retail Sales Tax (RST) reporting, but has never paid sales tax to the Department. Sixth, there is no evidence that there even is a leasing stream between taxpayer and lessee upon which sales tax would be collected. Taxpayer has failed to prove that it is conducting any business at all, let alone that it leased the aircraft in the regular course of its business as required by 45 IAC 2.2-5-15(c)(2)

After reviewing all of the factors here, the Department notes that a lease is defined as "[a] contract by which the rightful possessor of personal property conveys the right to use that property in exchange for consideration." Black's Law Dictionary 898 (7th ed. 1999). The parties' agreement reflected the fact that pilot/lessee never expected to pay consideration sufficient to justify recognizing the agreement as a lease. Instead, the lease agreement falls squarely within the definition of a "sham transaction." The "sham transaction" doctrine is long established both in state and federal tax jurisprudence dating back to Gregory v. Helvering, 293 U.S. 465 (1935). In that case, the Court held that in order to qualify for a favorable tax treatment, a corporate reorganization must be motivated by the furtherance of a legitimate corporate business purpose. Id at 469. A corporate business activity undertaken merely for the

purpose of avoiding taxes was without substance and "[t]o hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose." Id at 470. The courts have subsequently held that "in construing words of a tax statute which describe [any] commercial transactions [the court is] to understand them to refer to transactions entered upon for commercial or industrial purposes and not to include transactions entered upon for no other motive but to escape taxation." Commissioner v. Transp. Trading and Terminal Corp., 176 F.2d 570, 572 (2nd Cir. 1949), *cert. denied*, 338 U.S. 955 (1950). "[t]ransactions that are invalidated by the [sham transaction] doctrine are those motivated by nothing other than the taxpayer's desire to secure the attached tax benefit" but are devoid of any economic substance. Horn v. Commissioner of Internal Revenue, 968 f.2d 1229, 1236-7 (D.C. Cir. 1992). The rental/lease rate charged by taxpayer for the aircraft in question here can only be considered a "sham transaction." The only reason to charge a fraction of the fair market rate for rental/lease of the aircraft and arrange for alternate compensation is to avoid tax. Since taxpayer was not involved in a valid lease or rental agreement with its sole customer the Department was correct to deny taxpayer's claim for the rental/lease exemption.

In conclusion, the Department reviewed all of the relevant information and properly determined that taxpayer did not qualify for the rental and leasing exemption found in 45 IAC 2.2-5-15. Taxpayer did not enter into a valid lease and has not been in the business of leasing the aircraft. Rather, taxpayer entered into a sham transaction as previously described. Under IC 6-8.1-5-1(b), the burden of proving the assessment wrong rests with the taxpayer. Taxpayer has failed to meet that burden.

FINDING

Taxpayer's protest is denied.

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